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The War on Independent Contractors

Very sophisticated adjudicatory authorities cannot even agree on what an 'employee' is. But we have adopted a legal scheme that subjects a business owner to being labeled a fraudster if she guesses wrong.

By Samuel J. Samaro

It has been a rough couple of years in New Jersey for companies wishing or needing to hire independent contractors instead of employees. In January of 2020, Governor Murphy signed a package of bills that significantly increased the penalties for mis-designating workers as contractors and provided the Department of Labor and Workforce Development ("the Department") with new enforcement powers to pursue alleged violators. Six months later, the governor signed additional anti-contractor legislation, this time, among other significant things, making it a violation of the New Jersey Insurance Fraud Prevention Act to fail to properly classify employees for the "purpose of evading the full payment of insurance benefits." In other words, to avoid making payments to the unemployment fund.

These developments followed a number of years of aggressive enforcement by the Department under the prior laws. Even before recent legislation made mistakes costlier, it appeared to lawyers representing companies that the Department was straining to find that contractors were employees, applying an unfair interpretation of the legal standard that ignored or misinterpreted settled case law. Appeals to the New Jersey Appellate Division were not proving helpful. In several notable instances, the Appellate Division sided with the Department in unpublished, per curium decisions. It took an Appellate Division win by the company in *East Bay Drywall, LLC v. Department of Labor and Workforce Development* to convince the Supreme Court of New Jersey to grant certification. Anyone hoping that the court would endorse a less restrictive approach to the problem was sorely disappointed.

The facts in *East Bay*, as in virtually all of the cases that make it as far as written opinion,

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concerned a type of worker with a non-traditional schedule engaged by a business with fluctuating labor needs. In that case, it was drywall installers working for a company that bid for projects installing sheetrock in new homes. When the company's bid was successful, it would see who was available among the installers it knew and then hire them on a per-project basis. It did not need (and probably could not afford) full-time installers.

Because the installers were viewed by East Bay as subcontractors and not employees, taxes were not taken out of their checks, and employer contributions were not made on their

behalf to the unemployment fund. The Department audited East Bay and determined that 16 of its installers were in fact employees, not contractors, and assessed the company $42,120.79 for unpaid unemployment contributions.

By statute in New Jersey (and a number of other states), whether a worker is an employee or an independent contractor is determined by application of the so-called ABC test. Unless all three of the following requirements of the test are met, the worker is an employee:

A. Such individual has been and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact; and

B. Such service is either outside the usual course of business for which such service is performed, or that such service is performed outside of all the places of business of the enterprise for which such service is performed; and

C. Such individual is customarily engaged in an independently established trade, occupation, profession or business.

Applying that test to the facts in *East Bay*, the administrative law judge disagreed with the Department's auditor and held that 13 of the 16 installers were in fact contractors. After de novo review, the Department disagreed with the ALJ and reinstated the auditor's findings. The Appellate Division, in a published opinion, then disagreed with the Department and held that 11 of the installers were contractors. Finally, the Supreme Court disagreed with the Appellate Division and held that all 16 were employees.

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One of the challenges for anyone appealing a final decision of an administrative agency is the standard of review. It is highly deferential, justifying reversal only when the decision is "arbitrary and capricious," "clearly erroneous" and/or "plainly unreasonable"—something between "I might have done it differently" and palpably ridiculous. But, as this case illustrates, the gulf is wide, and the tipping point difficult to discern.

In the Supreme Court's view, it was not arbitrary and capricious for the Department to conclude that all of the workers failed part C of the test because East Bay Drywall failed to introduce sufficient evidence that the workers ran truly independent business entities. It acknowledged that the 11 deemed employees by the Appellate Division were registered as independent businesses and possessed business insurance, but noted that no proof was introduced before the administrative law judge for any of the workers concerning "the duration and strength of the business, the number of customers and their respective volume of business …

[or] the amount of remuneration each 'drywall subcontractor' received from East Bay compared to that received from others for the same service." Because, in the court's view, East Bay failed to meet the requirements of part C, it did not need to consider parts A and B of the test.

In other words, it is not enough to insist that your contractors be incorporated or members of an LLC with business insurance that they pay for. You must also ask them to disclose confidential information about the other entities for which they work (which may be competitors) and the dollar-value of the business they derive from those relationships. In a business where assignments are temporary and the roster of contractors ever changing, that is an impossible burden to place on a business or its contractors. It will be argued that the "right" to engage contractors is trumped by the admittedly legitimate concern that businesses will game the system to the detriment of workers and the solvency of the unemployment fund. But asserting that the concern trumps a rational, common and un-exploitive commercial practice is extremely shortsighted, and ignores where our society is going in deference to where it once was.

Like it or not, the so-called gig economy is here to stay. With ever increasing frequency, the drywall installer will drive for Uber on the weekends, write freelance articles when she doesn't have an installation job, and list her apartment on Airbnb when she wants to work for a month from Paris. That person does not want to be an employee. The most significant determinant of employment status has always been the right of control. That person does not want to be controlled. Employees owe their employers a duty of loyalty. That person does not want to be burdened by that or any of the other obligations that attend traditional employment.

The procedural history of *East Bay* (and a number of other cases) illustrates that very sophisticated adjudicatory authorities cannot even agree on what an employee is. But now we have adopted a legal scheme that subjects a business owner to being labeled a fraudster if she guesses wrong. The irony, of course, is that because of COVID-19 there has been a huge uptick in unemployment claims, thus creating a much larger shortfall in the unemployment fund, at the same time that more individuals are working from home, hoping not to return to the office, and looking for non-traditional ways of supporting their families. By definition, independent contractors do not qualify for unemployment compensation, and thus it is not fair to ascribe contractor mis-designation as a cause of the shortfall. Do workers who define themselves as contractors sometimes try to have it both ways and apply for unemployment compensation or disability benefits? Yes, certainly. But when, under application of reasonable criteria, such workers are in fact contractors and not employees, the answer is not to pay them the compensation and treat the businesses that engaged them as fraudsters. It is to treat such workers as rational actors with agency and say no.

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